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SUBJECT: HANG SENG ON WILD RIDE; BANK OF EAST ASIA SHARES SUSPENDED

REF: HONG KONG 1726

¶1. Summary: Hong Kong's Hang Seng Index (HSI) fell 7.4 percent during the morning trading session on September 18, before recovering to close roughly flat for the day. Trading in shares of HK's largest independent local bank, Bank of East Asia (BEA), were suspended related to an "unauthorized manipulation" in the recorded value of BEA's equity derivatives. Interbank lending tightened, and the Hong Kong Monetary Authority (HKMA) stepped in with US\$ 200 million of overnight liquidity for local banks. The HKG announced that it now receives the balance sheet of AIA, the large local operating subsidiary of AIG, on a daily basis, and that it is closely monitoring international transfers of funds from insurance companies registered in Hong Kong. Meanwhile, KPMG began the liquidation of two large Lehman Brothers subsidiaries in Hong Kong. End summary.

Wild Ride for Stocks; Bank of East Asia Shares Suspended

¶12. Hong Kong's Hang Seng Index (HSI) declined 7.4 percent in the morning trading session to a two-year low, before heavy buying in the afternoon allowed the market to recover and finish down only 0.03 percent for the day. Mainland banking, insurance and property company shares led the morning decline, with several major firms falling more than 10 percent.

¶13. HK's largest independent local bank, Bank of East Asia (BEA), announced the suspension of trading in its shares at 1430 HRS local time, pending "an announcement by the Bank in relation to "an unauthorized manipulation of the valuation of certain equity derivatives held by the Bank." BEA's press release stated that the bank's interim profit, as announced on August 5, will be restated to reduce pre-tax profit by HK\$131 million. The release stated, "There is no material effect on the Bank's balance sheet or capital, which remain significantly in excess of regulatory requirements." (Note: David Li, Chairman of BEA, reached a settlement with the U.S. Securities and Exchange Commission (SEC) in January 2008, related to SEC allegations of insider trading. Li paid a US\$ 8.1 million fine, but admitted no wrongdoing. End note.)

HKG Augments Inter-Bank Lending Market

¶14. HIBOR loan rates quoted by Hang Seng Bank at 1813 HRS local time were: 3.5 percent overnight; 4.0 percent for one week and one month; 2.8 percent for three months; and 2.75 percent for six months. The overnight rate rose 50 basis points from the previous trading day, and short-term liquidity in Hong Kong remained tight. Hang Seng Bank CEO Raymond Or confirmed in a

television interview on September 18 that his bank is restricting its lending activity in the inter-bank market "for the time being." Or said HIBOR rates would likely remain high in the near term. In response to this tightening mentality, the Hong Kong Monetary Authority (HKMA) announced on September 18 that it injected approximately US\$ 200 million (HKD 1.56 billion) into the overnight inter-bank loan market, in an effort to boost its liquidity.

AIG Local Subsidiary Firmly Under HKG's Wing

¶5. AIG's large local subsidiary, AIA, called a press conference on September 18 to reassure its customers. AIA Chairman Alwin Lam and General Manager Derek Yung claimed AIA is financially sound, with no liquidity problems. Yung confirmed reports from September 17 that AIA Hong Kong has been placed under the daily supervision of the HKG Commissioner of Insurance. The HKG took this extraordinary step to ensure that the financial strength of AIA is not transferred to its parent company, or to other AIG Group entities (reftel). He said AIA Hong Kong is operating without "interference" from the parent company AIG. He revealed that 2,000 policy holders canceled their insurance with AIA during the previous 48 hours. Yung said AIA's exposure to "subprime investments" accounted for less than two percent of the company's total assets.

¶6. Commissioner of Insurance Clement Cheung told local media on
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September 18 that the HKG is monitoring the financial status of Hong Kong's insurance operators. He said he requested AIA to deliver its balance sheet to his office on a daily basis. Cheung noted that the Commissioner of Insurance may seek help from locally registered banks, if necessary, to track down international financial transfers by insurance companies operating in Hong Kong.

¶7. Adding to local sensitivity about AIA's financial strength is the company's role as a registered trustee of the Hong Kong Mandatory Provident Fund (HKMPF), a retirement program established by the HKG in 1998 for Hong Kong's workers. Cheung emphasized that AIA's trustee role for the HKMPF is unrelated to AIA's insurance business, and that AIA has been well supervised and monitored by the Mandatory Provident Fund Scheme Authority.

Lehman Liquidation Launched

¶8. The Hong Kong Securities and Futures Commission appointed KPMG as a provisional liquidator for two major Lehman operating subsidiaries on September 18 -- Lehman Brothers Securities Asia Limited and Lehman Brothers Futures Asia Limited. KPMG's mandate is to ensure an orderly liquidation of the companies' outstanding contracts and other assets.